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# **Liberalization of International Financial Markets: The Record and Implications**

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**An Intelligence Assessment**

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# **Liberalization of International Financial Markets: The Record and Implications**

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**An Intelligence Assessment**

This paper was prepared by [redacted]  
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### Liberalization of International Financial Markets: The Record and Implications

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#### Key Judgments

*Information available  
as of 1 August 1987  
was used in this report.*

Since the late 1970s, Japanese and West European governments have selectively relaxed the regulations governing the operation of their financial markets. Although this liberalization has increased the financial options available to domestic firms, it has stopped short of opening home markets to widespread participation by foreign firms. As a result, companies in these regions now have the capability to tap a wider range of foreign capital sources as well as retaining preferential access to domestic funds. Limitations on US corporate access to foreign capital markets have hindered US firms' ability to offset the financial benefits gained by their foreign counterparts.

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Our analysis indicates that Japanese firms are reaping the greatest benefits from liberalization by aggressively exploiting international bond markets and raising both foreign and domestic equity capital. Although Tokyo has probably enacted the most comprehensive liberalization measures, including the elimination of foreign exchange and credit controls, its reforms have not extensively opened its financial system to foreigners. In addition, interest rates on most deposits remain regulated, giving firms access to a huge pool of low-cost funds. Moreover, strong banking ties provide firms a safety valve during financial shortfalls.

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We believe West European firms are also benefiting from the establishment of more market-oriented financial systems. Rome and Paris have promoted the development of their stock markets, have relaxed corporate restrictions on acquiring foreign capital, and have encouraged the development of new financial instruments. These measures have been particularly beneficial because they help to ease the tight supply of domestic funds—due in part to the need to finance large public debts. To ensure that funds reach domestic firms, however, the French and Italian Governments have preserved some barriers to foreign participation in their capital markets through currency and exchange controls. We believe that the modest liberalization measures undertaken in West Germany will not dramatically shift the financial activities of its firms because of its traditionally open capital markets and the dominant role played by the firms' banks.

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Despite continued domestic and foreign pressures for further liberalization, new measures are likely to be introduced more slowly as officials assess the impact of past changes on their financial systems and economies. The Ministry of Finance (MOF) in both France and Japan, for example, is

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reluctant to consider further market-opening measures until it is assured that it can maintain effective control of monetary policy. Similarly, we believe that Italian authorities are unlikely to allow measures that curtail their ability to finance public deficits.

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Reluctance by foreigners to completely liberalize their markets will frustrate US attempts to create a "level playing field"—an equalization of capital costs across countries and the removal of preferential aspects of foreign firm financing. We believe several additional measures would have to be taken by Japanese and West European governments to eliminate the preferential elements of their financing systems, including:

- Deregulating interest rates on the remaining 70 percent of deposits in Japan.
- Relaxing French and Italian currency controls.
- Lifting restrictions and limitations, as well as selected tax measures, which discriminate against foreign participation in Japanese and European bond and equity markets.
- The wide divergences in national tax systems.

Without additional pressure on foreign governments to further liberalize, we believe they will continue to limit outside participation in their financial markets.

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Scope Note

This study is part of a broader Directorate of Intelligence analytic program examining structural change in the global economy and the internationalization of world industry. It addresses shifts occurring in international financial markets, the way the international financial system is used, and the implications for economic and political balances.

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This study looks at the growing liberalization of financial markets in Japan, France, Italy, and West Germany; examines the growing changes in foreign financial markets; analyzes the resulting vulnerabilities and opportunities to foreign firms; and assesses liberalization's impact on the United States.

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## Liberalization of International Financial Markets: The Record and Implications

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### Introduction

Financial markets play a critical role in providing capital to industry and can have a significant impact on corporate competitiveness. A firm's ability to successfully match financial instruments with investment requirements can reduce the overall cost of a project and in many cases allow it to undertake riskier, but potentially higher payback, investments. Firms with special access to financial markets can maintain even more aggressive investment and pricing strategies than those that must raise capital in competitive markets. Indeed, the Japanese and most West European<sup>1</sup> governments have tightly controlled their financial markets since World War II to provide low-cost funds to favored industrial sectors and to control interest and exchange rates.

- *Italian* authorities restricted individuals' investment choices to bank savings—which channel funds to firms within the state-holding groups at favorable terms—and to government bond purchases.
- Although *West Germany* has established few controls to ensure the availability of funds, the German preference for low-risk investments, notably bank deposits, enhanced the dominance of the banks and ensured high levels of loanable funds.

As a result, these countries developed strong banking institutions and undeveloped equity and bond markets (see inset and figure 1).

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The ability of governments to channel large amounts of low-cost savings through the banking sector, along with favorable tax treatment of interest payments, fostered high corporate debt. Extensive government subsidization of interest rates further enhanced the attractiveness of debt finance. According to trade journals, the finance ministries in many countries cover the difference between the market rate and preferential rates on bank loans. Our analysis indicates that Rome has provided the most extensive subsidized financing, which has accounted for nearly 75 percent of the credit extended to Italian firms by the special credit institutes. In 1984 nearly 40 percent of the funds raised by French corporations were obtained at preferential terms. The state ownership of the largest commercial banks in France and Italy also facilitated the flow of funds between the state and financial institutions.

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We believe the predominant use of debt has provided foreign firms with several advantages over their US counterparts. High debt reduces the significance of

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### The Postwar Regime

To rebuild domestic industry after World War II, governments limited the choices of investment to ensure that household savings flowed mainly to banks that, in turn, lent to the corporate sector:

- In *Japan*, regulated interest rates on deposits, coupled with a high savings rate, provided a large pool of cheap funds for industrial development. The easy accessibility, higher rates, and tax exemption of postal savings attracted many depositors.
- *French* deposit rates were also controlled, with capital routed from savings and postal banks to the Caisse des Depots et Consignment (CDC), which loaned funds to public and private banks, which, in turn, provided preferential industry financing.

<sup>1</sup> In this study, Western Europe refers primarily to France, Italy, and West Germany.

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### Powerful Banking Structures

Powerful banking institutions and systems in Japan and Western Europe have been both the cause and result of heavy corporate leveraging. Varying degrees of government intervention, institutional ownership, and lending practices, however, have created significant differences between banking structures across countries. Moreover, the pattern of corporate-lender relationships that has evolved has substantially affected risk assessment and corporate debt levels in these countries. [ ]

**Japan.** The Japanese financial system was designed to enhance the ability of banks and financial authorities to allocate credit to industry. The small number of major banks in Japan—13 city banks backed by nationwide branch networks—centralized the supply of investment capital, allowing major corporations to raise funds efficiently. Moreover, the postal savings systems, which provide huge amounts of low-cost funds, under central bank supervision, have kept interest rates low. In the past, banks periodically needed Bank of Japan refinancing and thus became subject to government guidance on the allocation of loans among industries. This guidance bolstered banker confidence in the ability of targeted borrowers—firms integral to Tokyo's vision of industrial development—to sustain high debt levels. [ ]

In addition, the Industrial Bank of Japan and Long-Term Credit Bank provide a significant level of medium- and long-term industrial finance. Unlike the city banks, the long-term banks are allowed to obtain funds from bond issues to compensate for their lack of a deposit base. In turn, because government bond issues dominate the domestic market, the Bank of Japan can reduce long-term lending rates by reducing rates on new issues even though the banks are privately held and legally free to determine lending rates. [ ]

Although most commercial bank lending is short term, explicit or implicit rollover agreements allow Japanese corporations to view these funds as long-term liabilities. Investment risks are, in fact, substantially reduced by a large home market remote from

foreign competition and, in many cases, by the internal demand of highly integrated Japanese firms. The bank counts on the firm as a stable source of loan demand and, in return, implicitly guarantees that funds will be available to the company. In addition, trading companies have often acted as financial intermediaries by borrowing funds from group banks and relending to medium and small firms considered too high risk by banks. [ ]

**France.** French financial institutions are characterized by an extremely complex set of intermediaries, most under government control, which channel household savings into corporate investments. Over the past several years, banks supplied more than 75 percent of the funds raised by French corporations. Commercial banks are dominated by three government-owned banks—Banque Nationale de Paris, Credit Lyonnais, and Societe General—which account for roughly 70 percent of all deposits placed in France's 275 deposit banks. Although these banks operate as private institutions, the chairmen and managing directors are appointed by the government, and each bank has a government representative on its board of directors. The Banque de France exercises close control over the amount and cost of financial assets available to firms. As in Japan, commercial banks rely on central bank refinancing of medium- and long-term industrial loans—often at preferential terms—and are thus subject to administrative guidance. [ ]

The central government further influences business borrowing via interest rate rebates on long-term industrial loans, largely to small- and medium-sized firms, made by special credit institutions such as the Credit National and Credit Hotelier. Investment funds provided by these institutions are often raised on the French bond market under government guarantee. Direct loans by the Credit National make up about 5 percent of all industrial finance in France. The bank has tended to take the lead in the development of industries of national interest because French commercial banks have not been particularly supportive of riskier, long-term investments. Bank profitability has been depressed by the artificially low

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government-regulated lending rates, and, until recently, government-imposed ceilings have limited the total amount of credit that may be extended. [ ]

Over the past several years, Paris has encouraged reforms in the banking sector aimed at improving the efficiency and allocation of capital. Changes include: the creation of new financial instruments to better suit the needs of both investors and borrowers; deregulating financial markets; and loosening the system of credit controls. Because the financial sector has been tightly controlled in the past, innovative corporate and bank financing practices may take some time to develop. [ ]

**Italy.** Financial institutions in Italy are dominated by the extensive ownership of state holding groups. Having controlling interest in a multitude of firms, the holding companies facilitate the flow of inexpensive funds to corporate borrowers. Three of the biggest commercial banks—Banca Commerciale Italiana, Credito Italiano, and Banco di Roma—are owned by the largest Italian holding company, Istituto per la Ricostruzione Industrie (IRI), and, along with a few other commercial banks, channel their substantial deposit base to industrial firms. They are limited to short-term loans but, like Japan's city banks, they often roll them over into long-term loans. However, Bank of Italy requires banks to meet large reserve requirements and obligates them to purchase government bonds. This restricts the volume, and increases the cost, of bank lending. In addition, subholding companies within IRI provide government-subsidized funds to specific industrial sectors. [ ]

Special credit institutes provide the majority of long-term credit to firms. Istituto Mobiliare Italiano (IMI), the primary lender to the industrial sector, provides over 25 percent of all medium- and long-term credit. These institutes raise funds mostly by issuing bonds, and, because they are predominately state owned, their lending activities are highly influenced by government policies, many of which are based on political bargaining and connections rather

than on economic considerations. Although ordinary lending is carried out at market rates, capital provided for "special activities" is generally provided at subsidized rates, with the Bank of Italy making up the difference. [ ]

**West Germany.** In the West German financial system, a few large banks are crucial in attracting long-term deposits and relending to industry. The central government has not taken advantage of the financial system to guide lending activities. Financial policies are generally macroeconomic, with sectoral assistance provided by specific public lending institutions. The banks also dominate the bond market and own or control major blocks of corporate stock, thus providing them a major role in corporate decision-making. [ ]

The interlocking relationship between the financial and industrial sectors is perhaps greatest in West Germany. Besides voting their own corporate shares, banks generally receive authorization to represent the interests of customers whose stock they hold on deposit. Because of this equity holding, as well as substantial corporate loans, bank directors sit on and frequently chair business supervisory boards; 570 bank executives, for example, are on the supervisory boards of the top 400 companies. At a minimum, banks are interested in ensuring that decisionmaking is consistent with long-term return to capital and thus the ability to repay the extensive long-term bank exposure. The firms benefit from the information bankers bring to the boardroom and from the greater degree of certainty that financial support exists for corporate decisions. [ ]

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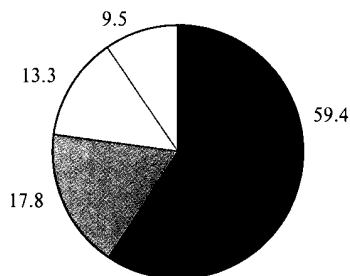
**Figure 1**  
**Corporate Finance: Distribution of Liabilities, 1984<sup>a, b</sup>**

Percent

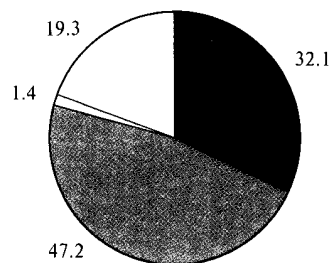
■ Equity<sup>c</sup>      □ Bonds  
 ▨ Borrowed      □ Other<sup>d</sup>

**United States**

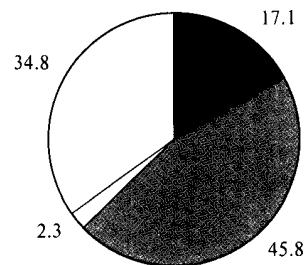
Total=4,791 billion US \$

**Italy**

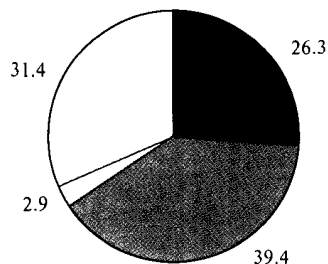
Total=72 billion US \$

**Japan**

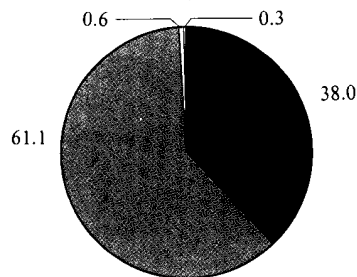
Total=2,670 billion US \$

**France**

Total=57 billion US \$

**West Germany**

Total=720 billion US \$

<sup>a</sup> Nonfinancial corporations.<sup>b</sup> 1983 data for Japan, France, and Italy.<sup>c</sup> Includes share capital, reserves, and provisions.<sup>d</sup> Includes trade credits and other accounts payable.

Source: OECD Financial Statistics.

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shareholders and their pressures for short-term profits. Moreover, the resulting close bank-firm relationship has enabled firms to concentrate on long-term market growth, and thus pursue aggressive investment and pricing strategies. US firms—because of their greater reliance on equity—must maintain higher profits and generous dividends for their shareholders. In addition, debt payments are deductible and dividend payments are not, allowing foreign firms to reap larger tax benefits than US firms. [ ]

There are several disadvantages, however, to a reliance on debt financing. For one, high leverage increases the risk of bankruptcy. Firms can become particularly susceptible to fluctuating interest rates, which can cause severe financial strains during recessionary periods. Perhaps more important, the lack of an active equity and venture capital market has limited the cultivation of small, innovative firms because new companies have difficulty obtaining loans. Furthermore, because of limited alternative financing sources, foreign firms are vulnerable to severe capital shortages when the public sector, as in France and Italy, places extensive demands on the financial markets. [ ]

### Pressures for Change

A combination of pressures has prompted the Japanese and Europeans to open and to more fully develop their financial markets. Demands from other governments and industry, especially the United States, have encouraged many countries to implement and/or speed up liberalization measures.<sup>3</sup> In particular, significant US pressures on Tokyo to rectify distortions in the relative yen value and deregulate interest rates have fostered changes. Similar demands from other countries are also forcing Tokyo to further liberalize or face retaliatory action. West Germany, for example, has limited the activities of Japanese banks in Germany until its banks are given reciprocal freedom in Japan. [ ]



Increasingly strong domestic pressures—from both the corporate and banking sectors—have also promoted liberalization efforts. Companies continue to demand greater access to domestic equity and foreign capital markets in order to obtain more balanced investment portfolios, to finance overseas investments, and to hedge against currency fluctuations. Moreover, bankers, particularly in Japan, complain that they need the freedom to enter foreign markets to offset the reduced domestic demand and to take advantage of international interest rate differentials between deposit and lending rates. [ ]

Liberalization has also been pressed forward by the growing importance of institutional investors, as well as by individuals demanding higher returns on investment. Pension funds, for example, have grown tremendously in both Japan and Western Europe, pressuring governments to remove restrictions on overseas investments and on participation in various financial instruments. In Japan, at least half the pension-fund assets must be placed in guaranteed investments such as corporate or government bonds; and, in Germany, most funds cannot be invested abroad. Similarly, individuals, once satisfied with safe, low-yielding bank deposits, now want alternative, higher return choices. [ ]

Governments themselves are recognizing the problems of past regulatory policies and are establishing measures that allow the market to determine credit availability and allocation (see inset). In France and Italy, for example, efforts now center on increasing corporate efficiency rather than propping up failing industries to maintain employment levels. In addition, the need to foster small, innovative firms—vital to promoting high-technology developments—is also compelling governments to improve their stock exchanges and, in a few countries, to develop secondary markets. [ ]

<sup>3</sup> Rapid technological change in the communications sector has facilitated liberalization. Technology has not only linked isolated markets, increased transaction speed, and reduced its costs, but it has also increased investor awareness and access to information. [ ]

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**UK Financial Markets**

*The British financial sector recently underwent significant liberalization, the so-called Big Bang.<sup>a</sup> These measures, instituted in October 1986, were aimed at increasing the efficiency of the British financial markets and keeping them competitive with those in New York and Tokyo. Major features of the Big Bang include:*

- *Abolition of fixed commissions on stock trading.*
- *Combining the activities of jobbing—those who actually buy and sell securities and make a profit on that spread—and brokers—those who buy and sell securities for their clients from jobbers and make a profit on the commission.*
- *An end to restricted trading on the British Government securities market.*
- *Allowing foreign firms to become members of the London Stock Exchange.*
- *The creation of a sterling-denominated commercial paper market.*

*Except for the creation of the commercial paper market, the Big Bang focused on the securities industry and should have little effect on UK corporate financial decisions. Indeed, UK capital markets and the financial structure of UK firms closely resemble those in the United States. Specifically, British markets are open to international capital flows and provide the diversity of financial instruments found in the United States. In addition, UK firms must maintain debt-to-equity structures that ensure favorable securities' ratings. Because of these similarities, we have focused on liberalization in the more closed capital and corporate financial environments of France, Italy, and West Germany.*

**Liberalization Taken to Date**

The liberalization measures taken to date by Japan, France, Italy, and West Germany are increasing both the foreign and domestic financial options available to their firms and banks. Although the extent and nature of these changes vary among countries, the selected removal of regulatory measures and barriers to free capital flows is not only spurring the development of, and demand for, domestic equity and bond markets, but also is opening access to international capital markets as well. Our analysis indicates that:

- **Japan** has probably enacted the most comprehensive liberalization measures, including elimination of direct foreign exchange and credit controls.
- **Italian** and **French** authorities have also taken major steps toward establishing more market-oriented systems. Rome has rapidly increased the development of its stock market and relaxed restrictions on acquiring foreign capital. Similarly, Paris has freed French capital flows as well as encouraged the development of new financial instruments.
- **Bonn** has encouraged foreign participation in its market by abolishing withholding taxes on bond purchases and removing its quota system on foreign bond sales.

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Despite these differences across countries, several common goals exist, including the introduction of new financial instruments, a greater reliance upon market-determined interest rates, and increased competition among financial institutions.

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**Deepening Equity Markets**

Many measures have focused on further developing and deepening domestic equity markets. Several markets, such as the Italian Bourse and the Tokyo Stock Exchange, have grown rapidly in the last few years (table 1). According to financial analysts, this rapid growth is lowering investor risk and spurring innovation and entrepreneurial behavior. Indeed, deregulation is creating greater incentives for firms to list on stock exchanges:

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**Table 1**  
**Stock Markets: Relative Size and Growth, December 1985**

	Italy	France	West Germany	Japan	United States
Number of firms listed	180	683	451	1,444	3,000
Market value of outstanding shares ( <i>billion US \$</i> )	60.8	71.8	154.1	859.0	1,886.1
Average annual market growth rate since 1982 ( <i>percent</i> )	44.9	34.4	35.7	27.2	14.4
Turnover ( <i>billion US \$</i> )	14.3	17.8	75.5	321.2	970.5
Average annual turnover growth rate since 1982 ( <i>percent</i> )	72.2	26.0	75.4	31.5	28.3

- New measures have relaxed stringent listing requirements on the **Japanese** stock exchange and have eased foreign investor access to Japanese securities.
- In **Italy** legalization of mutual funds in 1983 has channeled over \$3 billion of new capital into the Italian Bourse. Stiffer enforcement against insider trading and market manipulations has also increased investor confidence.
- The linking of **West Germany's** eight stock exchanges under one computerized system should promote more efficient trading and attract new listings. The relaxation of listing requirements should reduce issuing costs.
- Although still small, **French** Bourse activity has increased because of expanded trading hours and the greater participation of banks and brokers—tax concessions on equity investment have provided incentives to investors and the government continues its privatization program.

Italian firms have made the most dramatic shift to equity issues. The largest companies account for most of this activity. Olivetti, for example, has tapped the Bourse for over \$900 million in shares and Fiat issued

\$700 million in shares last year. State-owned companies are also lessening their dependence on government support and are forecasted to raise \$4 billion this year through nonvoting share issues.

Japanese corporations are also increasing the use of equity capital. Although Italian firms have mainly exploited their domestic market, Japanese companies have aggressively raised both domestic and foreign equity. As a result, their reliance on debt is falling. Indeed, equity on Japanese corporate balance sheets has risen from 18 to 24 percent over the last decade, largely as a result of raising funds overseas.

Although many French and West German firms remain skeptical of these markets, they are increasing their use of equity. According to European financial experts, the secretive nature of many German firms is hindering rapid development of the market. Our financial assessments indicate that the high profitability of many German firms allows them to internally finance much of their capital needs, and their relatively easy access to additional bank credit meets any supplemental needs. Nevertheless, there are a few exceptions, such as Nixdorf raising \$225 million on the Bourse in 1986. In France the introduction of participatory shares, which provide minimum annual dividend payments to alleviate French distrust in

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**Table 2**  
**Venture Capital: Relative Market Sizes, 1982, 1984, and 1986**

	<i>Million US \$</i>			Number of Professional Venture Capital Firms		
	1982	1984	1986	1982	1984	1986
United Kingdom	500 <sup>a</sup>	2,629	4,500	36	99	110
Netherlands	110 <sup>a</sup>	526	650	NA	33 <sup>b</sup>	40
Japan	86	440	850	18	62	70
West Germany	120 <sup>a</sup>	225	500	NA	30	25
Italy	NA	122	NA	NA	7	NA
France	NA	114	750	16	30	45
United States	7,600	6,300	20,000	350	500	550

<sup>a</sup> Estimated.

<sup>b</sup> Includes only officially recognized venture capital firms.

equity, is enabling firms to raise needed capital and reduce their dependence on government financial support. [ ]

The growing use of equity has promoted the emergence of *venture capital* in Japan and Western Europe.<sup>4</sup> Indeed, venture capital investments in these countries, virtually nonexistent until the early 1980s, have grown rapidly (table 2). The realization that capital markets can promote commercialization of new technologies has prompted Japanese and European authorities to enact measures to encourage the use of venture capital. These measures, usually patterned after practices in the United States, are aimed primarily at reducing the capital gains tax and at promoting the development of secondary or over-the-counter (OTC) markets, which have less stringent listing requirements than the primary exchanges. We believe the growth in foreign venture capital—by providing funds to innovative high-technology startup firms—will slowly spur the formation of new firms and reduce their aversion to high-risk investments.

#### Growing Use of Foreign Capital

The relaxation of currency exchange controls and the abolition of constraints on raising capital abroad have enabled Japanese and West European firms to acquire a significant amount of foreign capital—not only to reduce their capital costs but also to hedge against exchange rate fluctuations when building overseas plants. In particular, firms are rapidly increasing their participation in international bond, especially Eurobond, markets (see table 3 and inset). A growing number of foreign firms are also listing on the large US equity market. [ ]

Japanese companies have been the most aggressive users of foreign bond markets. Indeed, the volume of overseas issues of bonds has been greater than domestic issues for the past three years. Generally, Japanese companies are increasing their foreign—particularly Euro- and Swiss-bond—issues because:

- Issuing procedures for Eurobonds are much simpler because of less government interference and, thus, are usually less costly.
- There are a variety of bond options that, until recently, were unavailable in most domestic markets.

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**Table 3**  
**International Bond Markets**

Million US \$

	1986	1983	1980
<b>Total</b>	<b>225,392.6</b>	<b>77,148.0</b>	<b>38,002.4</b>
Eurobonds	186,951.6	50,098.2	20,048.7
United States	38,642.7	6,114.0	4,395.0
Japan	25,351.0	6,952.5	1,745.8
France	12,509.9	6,103.1	1,753.8
Italy	4,841.5	1,204.4	978.9
Germany	10,183.5	2,450.9	0
Other	95,423.0	27,273.3	11,175.2
Foreign bonds	38,441.0	27,049.8	17,953.7
<b>By supplier</b>			
Switzerland	23,400.9	13,499.9	7,469.9
Japan	4,755.9	3,851.3	1,542.6
United States	6,064.4	4,735.0	2,736.4
Germany	NA	2,617.7	4,951.5
France	538.5	187.7	262.5
Italy	209.5	0	0
Other	3,471.8	2,158.2	990.8
<b>By borrower</b>			
Japan	9,020.0	6,677.8	2,042.5
United States	5,022.0	1,241.0	1,368.9
France	892.6	1,230.8	679.4
Italy	587.2	254.6	102.2
Germany	951.3	469.9	157.3
Other	21,967.9	17,175.7	13,603.4

- There is significant foreign demand for Japanese equity through the purchase of convertible bonds.

European corporations are also expanding their use of international bond markets because of government restrictions on domestic issues. Both French and Italian firms have moved strongly into Eurobonds over the last few years, doubling and tripling their overseas volume, respectively. International bond issues by West German firms, on the other hand, remain low.

**International Bond Markets**

*Liberalization measures are increasing corporate access to a variety of international bond markets. In general, firms can issue bonds in a single foreign market or can issue bonds simultaneously on numerous Eurobond markets—bonds underwritten and sold in more than one country and available in any major currency. Eurobond issues have greatly out-paced foreign bonds in recent years because of several advantages, including:*

- *The avoidance of national regulations such as formal disclosures, exchange listing obligations, and requirements that control the volume of bond issues.*
- *Exemptions from domestic withholding taxes on interest payments.*
- *The ability to simultaneously list on various mar-*

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*kets, which expands the scope of potential investors and improves the chances of a successful issue.*

*The diversity of bond types and features has grown as quickly as the markets. Floating-rate, dual-currency, and zero-coupon bonds can reduce the cost and/or the risk of using foreign capital. Dual-currency bonds, for example, hedge against exchange rate volatility by allowing the borrower to make interest payments in the currency borrowed, and the principal in another currency. Floating-rate bonds, by protecting the lender against interest rate fluctuations, reduce initial interest costs and enable firms to borrow funds they may not be able to acquire otherwise. The recent introduction of swaps—which enable borrowers to shift bonds between fixed and floating interest rates as well as among different currencies—is further expanding the scope and use of international bonds. Swaps also enable firms to borrow funds in one currency and swap them for funds in another at a cost lower than could be borrowed directly in the second currency. Nearly 70 percent of all new issues on the Eurobond market involve swaps.*

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**Internationalization of the Yen**

*The liberalization of Japan's capital markets is expanding the use of the yen in international financial transactions. The size of Japan's economy has increased the demand for yen-denominated financing in international transactions and increased its use as a reserve currency, forcing the yen to expand its role among international currencies. Indeed, both external bank loans and Euromarket transactions denominated in yen have risen sharply since the early 1980s.*

*Continued yen internationalization will have important implications for Japan's capital markets and for its economic policy making. For one, the development of the Euroyen and samurai bonds—foreign bonds issued in Japan—and other new financial instruments is beginning to give foreigners the opportunity to tap Japan's capital markets. In addition, international financial experts believe the growing demand for yen-denominated securities will bid up the cost of Japanese capital and encourage Japanese firms to look abroad for financing. Consequently, Tokyo's ability to "guide" the economy through credit controls is not as extensive as in the past, and authorities have shifted to more market-oriented financial controls, such as moving to establish a government bond market to better control the money supply. As a result, Tokyo is moving slowly to fully liberalize its capital markets and expand the international use of the yen.*

In the international bond markets, Swiss franc- and dollar-denominated bonds are the most favored by corporate borrowers. Switzerland's firm monetary control, relatively low interest rates, and stable currency have attracted large numbers of foreign issuers. Similarly, the strong US economy and the well-regulated US financial system have attracted many foreign issuers to dollar-denominated bonds. The ease of access to Switzerland's large capital pool and the dominance of the dollar in international trade have ensured that these markets continue to attract capital.

Liberalization measures, however, are increasing the international importance of other currencies—especially the yen (see inset).

Euroequities—issues specifically targeted for nondomestic markets—have grown rapidly (figure 2). According to corporate issuers, the primary advantage of this market is to simultaneously list on all European markets in order to broaden their investor base and to increase share valuations through greater demand. The UK and Swiss markets are the most active because of their lax listing requirements. However, future growth may slow as the differing tax, accounting, and disclosure laws across Europe hinder accurate evaluation of corporate performance. Moreover, trading and distribution of shares are complicated by varying national regulations.

Governments—particularly Rome and Paris—have also begun taking measures to attract foreign investors to their domestic capital markets. These moves reflect a growing desire to deepen their capital markets and to keep pace with the growing number of new and innovative financial instruments available in the US and UK markets. Measures taken to meet these concerns include:

- The establishment of the Eurolira market in Italy to attract foreign capital.
- The reopening of the French bond market in 1985.
- The abolition of withholding taxes on interest income to nonresidents in Germany and Japan.
- The introduction of bonds with option features in all the countries to increase corporate financing flexibility.

**Limited Bond Use**

Despite measures to expand the use of domestic bond markets, corporate use remains low (see table 4). Governments are increasingly permitting the issuance of a variety of bond types and options—such as convertible and zero-coupon bonds—to lower bond costs. Restrictive issuing requirements have also been relaxed, increasing the number of firms allowed to participate in the market as well as reducing the associated transaction costs. Reform, however, has not eliminated all restrictions facing firms in the bond

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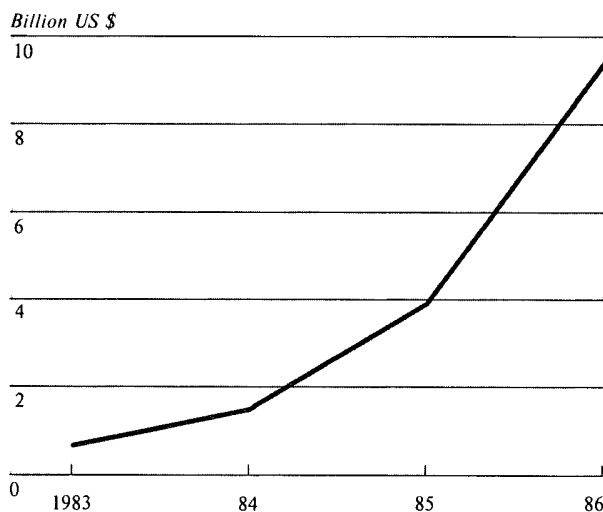
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**Figure 2**  
**Growth of Euroequity Markets, 1983-86**



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market. Japanese authorities continue, for example, to require firms to provide collateral on most bond issues and to set market yields below those on the secondary market—perhaps because of the government's own reliance on bonds to finance debt. In France and Italy the bond market is dominated by government issues to finance public deficits and the state-owned enterprises, effectively crowding out private issues.

#### Continuing Impediments to Full Liberalization

Despite the sweeping changes to date, Japanese and West European financial markets are not fully open. Although past measures have significantly enabled domestic firms to acquire new sources of foreign and domestic capital, governments continue to protect their capital markets from foreign participation and to ensure that sufficient, low-cost capital flows to domestic industry. We believe that a combination of

remaining restrictions (table 5) and old traditions continues to restrict competition within each market.

In Japan the control over interest rates that account for nearly 70 percent of bank deposits continues to provide low-cost funds to the industrial sector as well as to keep funds away from bond and equity markets. Also, strict requirements and procedures limit the attractiveness of many financial instruments. The issuance of samurai or shogun bonds, for example, requires notification and often collateral that create costly delays. The Japanese offshore market, created in 1986 to avoid domestic regulations, is subject to restrictions that inhibit their attractiveness, such as limiting the flow of funds between domestic and offshore accounts, subjecting accounts to local taxes and stamp duties, and prohibiting participants from issuing certificates of deposit (CDs) or holding debt securities in their offshore accounts.

Significant impediments also remain on West European financial markets. Most important, capital and exchange controls continue to inhibit the free movement of funds across markets:

- Although foreign exchange controls have been relaxed in *France*, restrictions on lending francs to nonresidents (to limit the expansion of the Euro-franc) remain. The central bank controls short-term interest rates by establishing credit volumes and restricting access to the interbank market.
- *Italy* continues to limit domestic investments in foreign companies to ensure that funds remain available to finance public deficits and domestic industry. Outsiders are also prohibited from being licensed as brokers or becoming members of the stock exchange.

The continued dominance of the banking sectors and government control over domestic funds are also hindering further liberalization:

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**Table 4**  
**Bond Markets, Size, and Distribution of Issuers, 1986**

*Percent*  
(except where noted)

	Total Bonds Placed (Billion US \$)	Government <sup>a</sup>	Public Sector	Financial Institutions	Private Enterprises	Foreign
Japan	430.8	36.4	7.1	44.8	10.7	1.1
France	47.6	47.7	41.4	0 <sup>d</sup>	10.5	0.4
Italy	110.5	82.1	5.9	10.9	1.0 <sup>b</sup>	0.1
West Germany	135.5	24.9	2.7	59.3	0.3	12.8
United States	750.3	62.1	6.3 <sup>c</sup>	15.5	15.2	1.0

<sup>a</sup> Includes local and state governments.

<sup>b</sup> Includes entire private sector in Italy.

<sup>c</sup> Government-sponsored lending agencies in the United States.

<sup>d</sup> Aggregated with the public sector.

Source: OECD financial statistics.

- In **Japan** the considerable cross shareholdings between banks and industry not only provide a predictable and stable financial base for firms but also create barriers to foreign financial institutions competing for Japanese clients.
- In **West Germany** the ability of banks to offer their corporate clients a full range of financial services, including lending, bond underwriting, and equity placements, as well as holding shares themselves, effectively limits foreign competition.
- In **France** and **Italy** the primarily state-owned banking sectors continue to control much of the capital and are able to provide low-cost funds to industries targeted by their respective governments.

The lack of well-established credit-rating agencies is also inhibiting investor willingness to purchase new financial instruments.

### Assessing the Impact

We believe liberalization measures taken to date are providing increased opportunities for Japanese and West European firms, particularly in foreign and international markets. At the same time, foreign

access to their markets remains limited, preserving many of the past advantages of their closed markets, such as the ability of firms to operate at high debt levels and continued government financial support to failing companies or targeted industrial sectors. Partial liberalization also gives foreign firms time to adjust their financial structures as well as limit potential vulnerabilities, such as greater investor pressures for short-term financial returns and the exposure of firms with high debt to interest rate fluctuations. Even if markets are fully liberalized over the next several years, which is unlikely, and Japanese and West European firms lose many benefits of their protected financial systems, we believe that the close banking-industry ties will remain—although increasingly weaken—as banks continue to hold corporate shares, providing domestic firms preferential access to funds.

### Japan

Our analysis indicates that Japanese firms are reaping the greatest gains from liberalization. Japanese firms have already proved themselves adept at pursuing financial alternatives, such as issuing convertible debentures in international capital markets. By aggressively exploiting new domestic and foreign opportunities, Japanese firms are increasingly able to match

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**Table 5**  
**Liberalization of Foreign Financial Markets: Remaining Impediments**

Area	Impediment	Effect
Japan	Tight eligibility and listing requirements.	Issuance of samurai bonds is difficult and costly.
	Controls on the interest rates on about 70 percent of all deposits, despite promises to totally lift restrictions.	Domestic interest rates remain low, and the extensive postal savings system funnels enormous funds away from capital markets.
	High fixed commissions for underwriting bonds.	Increases bonds' issuing costs and prevents experienced US securities firms from competing for Japanese business on price.
	Quotas on foreign work permits.	Limits the ability of foreign financial institutions to expand the size and scope of their activities, regardless of the equal treatment afforded them. At the same time, the tremendous pressures placed on Japanese employees to remain loyal to their Japanese employers hinders the ability of foreign companies to obtain experienced Japanese personnel.
	Lack of domestic commercial paper market. (Planned for October 1987)	Prevents corporations from obtaining short-term debt without costly bank intermediation.
	Practice of issuing shares below market price and high issuance fees.	Issuance of shares is relatively expensive, discriminating against their use.
	Limitations on foreign investments by institutional investors, such as pension funds and insurance companies.	Limits the ability of investors to obtain higher rates of return and ensures a greater supply of funds for domestic borrowers.
	Foreign firms not allowed to list on the over-the-counter market.	Excludes small foreign companies from obtaining equity capital from the new market.
	Lack of well-established credit agencies.	Inhibits capital acquisition by unknown firms about which investors lack useful data for investment decisions.
	Lack of financial futures market.	Prevents hedging of foreign exchange and interest rate risks.
Western Europe	French and Italian currency and investment controls.	Limits the extent of foreign ownership in domestic companies and discourages foreign companies and financial institutions from operating in their capital markets.
	French banks remain restricted in lending French francs to foreign borrowers.	Ensures that adequate levels of funds are available for domestic borrowers as well as limiting the demand and keeping interest rates down.
	French citizens prohibited from opening bank accounts in foreign currencies.	Restricts access to foreign exchange that may depress domestic interest rates.
	A 10-percent limitation of total assets on foreign investment by Italian mutual funds.	Encourages that capital is available domestically. This measure has resulted in Italian firms selling equities at prices significantly above their real market value because of the lack of alternative investments.
	The interest on Italian bank deposits remains taxed at 25 percent while government securities are tax free.	Allocates savings toward financing the government deficit rather than toward the capital markets.
	Set commissions for managing bond issues in West Germany.	This impediment, along with the extensive banking links to industry, makes it extremely difficult for foreign financial institutions to establish themselves.
	West German turnover tax of 25 percent on stock exchange transactions.	Increases the cost of participating in equity markets and inhibits investor growth.
	Foreigners prohibited in Italy from becoming licensed brokers or stock exchange members.	Restricts accessibility of foreign firms to equity capital.

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their operating and investment requirements with the most appropriate financial instrument, thereby reducing capital costs and risks. These opportunities are also allowing Japanese firms to circumvent remaining Japanese financial restrictions. For example, by issuing dollar-denominated bonds in Europe to Japanese investors, companies are able to obtain financing that is cheaper than domestic issues. Because the bonds are issued directly from Japan, they are considered domestic securities and do not count against current restrictions on foreign holdings. Access to a wider range of foreign financial instruments is also helping Japanese firms hedge the risks of moving production facilities offshore. [ ]

Although the opening of Japanese financial markets could increase the capital costs for Japanese firms as they are forced to compete for domestic funds, limited foreign access to Japan's huge pool of low-cost savings should continue to keep borrowing costs low. Indeed, the majority of postal savings continue to be government controlled and the MOF is taking new precautions to regulate lending rates, such as restricting bank lending to any single country to a maximum of 40 percent of the bank's capital. These limits have, in part, enabled Tokyo to keep its prime lending rates low as well as to provide domestic firms a cushion for financing shortfalls or investment needs. [ ]

As firms continue to reduce their debt levels and as the roles of financial institutions change, authorities will have more difficulty directing savings to favored industrial sectors. Tokyo, however, is using new avenues to continue these activities. For example, the Ministry of International Trade and Industry's (MITI) proposed industrial restructuring legislation requests funds—including subsidized loans and R&D tax credits—to assist firms to move into new technology areas and to carry out basic and applied R&D. Many financial analysts also believe that, as Japanese firms issue more equity, investor demands for high short-term returns will change the traditional long-term perspective of Japanese management. Most corporate stock, however, remains institutionally owned by banks and other firms within a particular trading company. As a result, short-term investor pressures are unlikely to materialize for some time. Japanese

firms are also using the gradual implementation of liberalization to reduce their high debt levels and better compete for international funds. [ ]

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#### **Italy**

We believe Italian firms will benefit substantially from liberalization measures. In the past, firms were dependent upon high-cost debt in the tight Italian capital markets. Liberalization, however, has enabled many firms to more efficiently obtain foreign capital, while the rapid growth of domestic equity markets is providing them a growing source of capital from both domestic and foreign investors. This improvement in the balance sheets, in turn, further enhances firms' ability to attract lower cost capital, particularly if future liberalization measures promote more competitive domestic capital markets. [ ]

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The rapid development of the stock markets will also enable Rome to more easily privatize its large number of state-held firms, thereby lessening its financial burden. Italian authorities, however, are fearful that the rapid rise in stock prices of several major companies, such as Olivetti and Fiat, may be artificial and could tumble quickly. Indeed, over the past two years most financial analysts have attributed much of the increase in stock prices to excess investor demand rather than improved corporate performance. If a stock market fall occurs, many financial analysts believe that investors will be frightened away, limiting the market's growth. While the regulatory bodies try to correct deficiencies, the current lack of experienced and knowledgeable financial analysts, and investments selected only on the basis of corporate reputation and size, have resulted in an unstable market, according to international financial experts. [ ]

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#### **France**

We believe liberalization will also be advantageous to French firms in the long run. The relaxation of domestic controls is increasing French companies' access to different financial instruments and lowering the cost of funds and financial services. Paris's enthusiasm to expand domestic financial markets has led to the creation of CDs, Treasury bills, and a commercial paper market. Commercial paper, in particular, is

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thriving as firms strive to reduce high borrowing costs and onerous terms. The relaxation of controls on overseas direct investment should also allow French companies to buy their way into foreign markets.

Recent efforts to modernize the domestic capital markets should improve the efficiency of credit allocation and facilitate the denationalization of many state-held companies and banks. Although these changes have created some uncertainty in the financial environment, they should benefit most French firms. Many state-held firms, however, are plagued by high losses and inefficient management and may be unattractive to investors. At the same time, many of these firms remain dependent on Paris for financial support and have come to expect credit at preferential rates, regardless of performance. Moreover, the current 20-percent limitation on foreign ownership will further reduce investor interest in privatized firms—especially to foreign companies that often view these investments mainly as a conduit to the protected French marketplace.

The privatization of the leading financial institutions may also cause future difficulties for state-held, as well as private, firms in acquiring capital. Many financial journalists believe French banks are unlikely to continue providing loans to companies showing weak financial performance as easily as they did in the past. The transfer of bank management from public to private hands will no doubt tighten loan eligibility requirements as financial institutions try to earn returns satisfactory to stockholders. This transition will be facilitated if the government guarantees corporate debt.

#### West Germany

We believe that modest liberalization measures in West Germany are not likely to dramatically shift the financial activities of West German firms. The slowly increasing importance of the domestic equity and bond markets, however, has enabled several German firms to reduce their dependence on bank debt. Although in the past, equity was held in a few private hands, usually family members, issues are increasingly being sold on stock exchanges, thus spreading the ownership. In addition to reducing the costs and risks

of high debt levels, rising equity levels will improve German firms' attractiveness in foreign capital markets—particularly important in light of the desire of German firms to increase their foreign operations. We expect closely held German companies, however, to move cautiously into public offerings.

German banks will continue to play the dominant role in domestic corporate financial activity. Because the banks are able to participate in a variety of financial services as well as to own corporate equity, they are likely to keep a lock on corporate financial needs. While foreign bank participation in Germany may grow, we believe the close ties between domestic banks and companies will remain strong. However, if easing tax regulations promotes an active CD market, firms may have more financial alternatives.

#### Outlook: Slowing the Pace

While liberalization has progressed markedly during the past five years, new measures are likely to be introduced slowly in coming years as officials assess the impact of past changes on their financial systems and economies. In particular, many regulatory bodies—facing diminishing authority and control over financial matters—are dragging their feet on implementing new measures. In addition, governments are being lobbied by interest groups that are seeking to protect their powerful positions.

Most new measures planned by Japan's MOF consist of further deregulation of deposit interest rates and continued development of new financial instruments, especially short-term notes such as commercial paper, which is currently prohibited. Further measures, we believe, will be enacted slowly and will have a lesser impact on corporate financing as officials assess the impact of previous actions. The MOF prefers to move slowly on liberalizing in an effort to protect domestic investors from excessive volatility. The Bank of Japan has indicated its reluctance to introduce new liberalization measures until it is assured that it can maintain effective control over monetary policy. Foreign

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pressures to further liberalize have also diminished as other issues, particularly trade imbalances, have taken precedent. [ ]

French planners are giving great attention to developing France's domestic capital markets as they move toward US-style monetary policy and away from quantitative credit restrictions. Although liberalization measures have only recently been initiated, authorities plan to expand the scope of financial instruments and to continue modernizing capital markets to facilitate corporate access. Privatization of France's largest public companies and financial institutions will necessitate a strong equity market to absorb the stock sales. Many French observers, however, believe that new measures will be of little benefit unless subsidized credit is ended and remaining foreign investment controls are eliminated. [ ]

Notwithstanding proposals to accelerate exchange reforms, Italian monetary authorities may prolong the implementation of new measures, such as permitting merchant banking activities by financial institutions and expanding the use of the lira internationally. According to State Department reporting, current proposals carry little that will amount to concrete changes from the current state of affairs. Furthermore, both the Minister of Finance and the President of the Bank of Italy warned of the financial system's rapid growth, particularly the stock market, and their decreasing ability to control it. Past difficulties, such as the exchange speculation in 1985, were followed by reimposition of regulations on foreign investors. We believe authorities will not allow any new measures that significantly curtail the ability of Italy to raise the capital needed to finance its deficit. [ ]

The West German financial system has been relatively free of currency and exchange controls since the late 1960s. Press reports indicate that future liberalization measures will focus on expanding the stock market, especially through modernization of the exchanges, and on abolishing any remaining regulations, such as the turnover tax on securities transactions, that hinder expansion of financial markets. The tight grip that the large German banks have on Germany's financial market, however, may limit the effectiveness of the new measures. [ ]

### Some Implications for the United States

The partial liberalization of Japanese and West European financial markets has pluses and minuses for US competitiveness. On the one hand, US firms are competing against foreign firms that not only retain many of their past government-supported financial advantages but also are now gaining access to the full range of international and foreign, particularly US, financial markets. As a result, we believe that foreign firms are strengthening their financial positions and diversifying the means to manage their assets, thereby reducing their costs and risks. At the same time, however, Japanese and West European constraints and regulations on outside participation in capital markets have prevented US firms from fully offsetting the gains of their foreign counterparts. [ ]

Over the longer term, the benefits of liberalization may be more fully shared by US firms. In particular, as liberalization becomes complete, the ability of governments to maintain large supplies of capital and artificially low interest rates for industry will be reduced. Liberalization to date has also enabled US firms to borrow yen and marks on the Eurocurrency markets at rates approaching the real interest rates obtained domestically by Japanese and West German firms. [ ]

Moreover, the increased flow of Japanese funds into the United States may alleviate demand for dollars, reducing upward pressures on US interest rates. As their markets are more fully opened to foreign customers, home firms will be competing in the same financial markets as US firms, facing the same costs and constraints. Moreover, the disadvantage faced by US firms because of their predominant use of equity, particularly the short-term pressures on profitability, may be reduced as Japanese and European firms raise their equity levels. [ ]

We believe several additional measures need to be taken by Japanese and West European governments to eliminate the preferential elements of their financial systems and create a "level playing field." The principal foreign impediments to equalizing the access to, and cost of, capital across countries include:

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- The deregulation of remaining interest rate controls, notably on smaller Japanese savings deposits, which provide preferential financing to domestic firms.
- The relaxation of remaining currency controls to ensure free movement of capital.
- The removal of strict requirements to participate in domestic bond and equity markets is essential to equalize access to alternative forms of capital.
- The wide divergences in national tax systems.

Left to their own devices, we believe that Tokyo, Paris, Rome, and Bonn will tend to focus their liberalization efforts on expanding domestic financial alternatives, while maintaining barriers to full outside participation in their financial markets.

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## Appendix

**Chronology of Foreign Liberalization Measures, 1980-86**

Country	Year	Measure	Effect
Japan	1986	Opening offshore markets.	Reduced regulatory and tax measures for domestic and foreign banks operating in Japan.
		Removal of interest rate ceiling on fixed deposits over 300 million yen.	Increase competition for bank deposits by banks, providing higher yields for individuals.
		Allowable overseas investments by insurance companies increased to 25 percent of assets from 10 percent.	Increased the outflow of yen and allowed greater access to higher yielding assets overseas.
		Further relaxation of Euroyen issuing requirements and credit-rating agencies established.	Promote international use of the yen and expand the number of eligible borrowers.
	1985	Fixed interest rates on fixed deposits over 1 billion yen were freed to fluctuate.	Increase competition among banks for funds, giving greater opportunities to Japanese investors.
		Allowed participation of nine foreign banks in the trust banking sector.	Increased competition for Japanese pension funds and savings, forcing higher returns for investors.
		Established a yen-denominated bankers' acceptance market and permitted flotation of conversion-currency and floating-rate Eurobond issues.	Enhanced internationalization of the yen by facilitating trade financing in yen and expanding the use of bonds and financial flexibility of companies.
		Allowed the introduction of yen zero-coupons, floating-rate, and dual-currency bonds.	Increased the flexibility of borrowers and brought the yen into line with options available in other bond markets.
		Admitted six foreign securities houses to the Tokyo Stock Exchange.	Provided greater foreign involvement in the Japanese market.
	1984	Eased guidelines on issuing CDs.	Expanded options to savers.
		Restriction relaxed against foreigners issuing Euroyen bonds.	Expanded the role of the yen in international transactions, increasing its availability for foreigners.
		Lifted ban against foreign exchange swaps.	Provided greater options to borrowers and investors, enabling them to hedge against exchange risks.
		Relaxed standards for issuing unsecured domestic bonds, yen-denominated foreign bonds, and Euroyen bonds by residents.	Expanded the role of the yen in international finance and allowed greater flexibility in corporate financial activity.
	1983	Relaxed criteria for listing companies on the over-the-counter stock exchanges.	Facilitated venture businesses and other small firms to go public and raise equity capital.
	1980	Amended Foreign Exchange and Foreign Trade Control Law, removing the restrictions on foreign investments and the explicit prior approval for transactions by the government.	Enabled residents to more easily invest in foreign securities and foreigners to invest in Japanese securities.
France	1986	Introduced Treasury bills for corporate purchase.	Allowed firms to invest directly in short-term government securities.

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**Chronology of Foreign Liberalization Measures, 1980-86 (continued)**

Country	Year	Measure	Effect
France (continued)	1986	Opened limited morning trading session on the Paris Bourse.	Expanded stock market activity and attracted greater corporate and investor participation.
		Futures market established.	Firms can hedge exchange and interest rates.
		Relaxation of exchange controls.	Enabled French firms to gain easier access to foreign capital and make direct investments abroad.
	1985	Authorized reopening of the Eurofranc market.	Expanded the source of funds for French industrial borrowers.
		Established negotiated commissions for bond issues.	Increased competition for new issuances through commissions, decreasing issuing costs to borrowers.
		CDs established.	Established a high-yielding deposit for individuals, enabling banks to better attract short-term funds.
		Commercial paper introduced.	Expanded the diversity of financial instruments, firms to direct and obtain short-term funds.
	1984	Abolished credit ceilings on financial institutions.	Increased the level of loanable funds available to French borrowers.
Italy	1980	Liberalized interest rates for all deposits for one year or longer.	Provided depositors access to higher yields by increasing competition among banks for deposits.
	1986	Non-interest-bearing deposit on foreign investment reduced from 25 to 15 percent.	Facilitated foreign investment by Italian companies and investors.
		Lifted restrictions on foreign borrowing by Italian banks.	Expanded sources of funds for banks to provide loans to industry.
	1985	Relaxation of foreign exchange controls.	Facilitated overseas investments by domestic companies and for export financing.
		Gradual reduction of bank obligations to invest proportion of deposits in public bonds.	Increase the volume of funds available to the private sector.
	1984	Lifted individual credit restrictions on banks.	Expanded volume of loanable funds available by banks.
	1983	Parliamentary decree allowing the creation of mutual funds.	Expanded alternative investment opportunities by providing higher yields and also by increasing credit availability to industry.
West Germany	1986	Relaxed minimum reserve requirements and authorized issuance of CDs.	Expanded the level of loanable funds for banks and created higher yielding instruments for depositors.
		Introduced new instruments to domestic bond market including zero-coupon, floating-rate, and dual-currency bonds.	Facilitated the internationalization of domestic markets and provided greater flexibility to corporate financing.
	1985	Subsidiaries of foreign banks in Germany were allowed, on a reciprocity basis, to be lead managers in foreign deutsche mark issues.	Expanded foreign participation in domestic capital markets.
		Linked the eight regional stock exchanges under one computerized system.	Should promote more efficient trading and attract new companies and investors.

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**Chronology of Foreign Liberalization Measures, 1980-86 (continued)**

Country	Year	Measure	Effect
West Germany (continued)	1984	Abolished the 25-percent coupon tax on foreigners' interest income from domestic bonds.	Increased incentive for foreigners to invest in domestic bonds.
	1981	Removed restrictions on nonresident purchase of domestic bonds.	Facilitated foreign access to domestic capital.

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